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The Impact of Financial Statement Comparability on Financial Reporting Quality and Cost of Capital: An Empirical Study on Egyptian Firms Listed in the Egyptian Stock Market

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Abstract

The research aims to test the relationship between financial statement comparability and each of financial reporting quality and cost of capital. It also aims to test the mediation effect of financial reporting quality on the relation between financial statement comparability and cost of equity, using a sample of non-financial firms listed in the Egyptian stock market for the period 2017-2020.

Financial statement comparability was measured using the model of De Franco et al. (2011), as the independent variable. While, cost of capital was measured using cost of equity, as a dependent variable. And financial reporting quality was measured using accruals quality, as an intermediate variable. The researcher used the path analysis, which is one of the structure equation modeling techniques, to test the research hypotheses.

The results indicated that there is a significant negative relationship between financial statement comparability and cost of capital. Also, there is a significant positive relationship between financial statement comparability and financial reporting quality. In addition, there is a significant negative relationship between financial reporting quality and cost of capital. Moreover, the results found that financial reporting quality mediates the relation between financial statement comparability and cost of capital, using accruals quality as an intermediate variable. Finally, the results of the additional test supported these results, through using cost of debt in measuring cost of capital

Key Words: financial statement comparability, financial reporting quality, cost of capital.

أثر قابلية القوائم المالية للمقارنة علي جودة التقارير المالية وتكلفة رأس المال: دراسة تطبيقية علي الشركات المقيدة في سوق الأوراق المالية المصري

ملخص البحث

يهدف هذا البحث إلى اختبار العلاقة بين قابلية القوائم المالية للمقارنة وكل من جودة التقارير المالية وتكلفة رأس المال. كما يهدف البحث أيضا إلى اختبار أثر جودة التقارير المالية كمتغير وسيط، على العلاقة بين قابلية القوائم المالية للمقارنة وتكلفة رأس المال، وذلك باستخدام عينة من الشركات غير المالية المقيدة ببورصة الأوراق المالية المصرية في الفترة 2017-2020 .

وقد تم قياس قابلية القوائم المالية للمقارنة باستخدام نموذج (De Franco et al. (2011، بينما تم قياس تكلفة رأس المال باستخدام تكلفة التمويل بالملكية، وتم قياس جودة التقارير المالية كمتغير وسيط، باستخدام جودة الاستحقاقات. ولاختبار فروض البحث، قام الباحث باستخدام أسلوب تحليل المسار، والذي يعد من أحد اساليب نموذج المعادلات الهيكلية .

أظهرت النتائج وجود علاقة معنوية سالبة بين قابلية القوائم المالية للمقارنة وتكلفة رأس المال، ووجود علاقة معنوية موجبة بين قابلية القوائم المالية للمقارنة وجودة التقارير المالية، ووجود علاقة معنوية سالبة بين جودة التقارير المالية وتكلفة رأس المال. وأظهرت النتائج أيضا أن جودة التقارير المالية تتوسط العلاقة بين قابلية القوائم المالية للمقارنة وتكلفة رأس المال، وذلك باستخدام جودة الاستحقاقات كمتغير وسيط. وأخيرا، فقد أيدت نتائج التحليل الإضافي النتائج السابقة، وذلك في ظل استخدام تكلفة المديونية لقياس تكلفة رأس المال .

الكلمات المفتاحية : قابلية القوائم المالية للمقارنة، وجودة التقارير المالية، وتكلفة رأس المال .

1-Introduction

Financial statement comparability and its consequences are very important issues in the literature of finance and accounting. Comparability can be defined as the extent to which similar economic transactions are accounted for similarly, and dissimilar transactions are accounted for differently (Chen and Gong 2019). In other words, comparability is the extent to which firms that have similar accounting systems can produce similar financial statements (De Franco et al. 2011). According to (SFAC No. 2) of the Financial Accounting Standard Board (FASB), comparability is the primary reason for developing accounting standards, as accounting standards harmonize the choice and application of accounting methods for similar firms.

Comparability allows users of financial statements to better understand the firm, its environment, and its accounting system. In addition, it helps in better understanding and predicting economic events, better translating these events into accounting performance, and eventually reducing information asymmetries.

Furthermore, comparability is very crucial to financial statements users, because comparability is the qualitative characteristic of the financial reporting information that helps in meeting the objective of financial reporting. This objective is to provide financial information about the firm that is useful for financial statements users in making their decisions, and financial reporting is the source of information for financial statements users who cannot demand the information they need to make their decisions. In sum, comparability in financial reporting is crucial for financial statements users in making more informed decisions.

Moreover, comparability makes financial reporting information useful, because the information can be compared with similar information of other firms or of the same firm at different periods. In addition, if users of financial statements cannot be able to make comparisons of alternative investment opportunities, their capital allocation decisions will be suboptimal. Therefore, greater comparability is associated with a richer information environment.

In sum, comparability is a critical qualitative characteristics of accounting information, which has many consequences for financial statement users, such as: increasing analysts' forecasts accuracy, reducing credit risk, having more efficient

acquisitions, increasing stock price informativeness, and increasing the accuracy of information released in managerial forecasts (Chen and Gong 2019). Therefore, this study will focus on two important consequences of comparability, which are improving financial reporting quality and reducing cost of capital.

Financial reporting quality is defined as reports that are more complete, neutral, free from errors, and provide more useful and predictive information about the firm's performance (Shuraki et al. 2020). The International Accounting Standards Board (IASB, 2010) states that comparability is one of the qualitative characteristics of financial reporting information, which enables information that achieves the objective of financial reporting. Whereas, the objective of financial reporting is to provide financial statements users with information that help them in making optimal decisions.

Therefore, we can conclude that comparability is an important characteristic of financial reporting. In other words, financial reporting quality is considered as a general feature of financial information, and comparability is one of the qualitative characteristics of accounting information, which refers to how the accounting information is presented. Therefore, comparability is important in increasing the quality of financial reporting.

Additionally, comparability identifies the similarities and differences across firms. This may constraint managers from opportunistic earnings management behavior. Moreover, comparability can reduce the cost of obtaining information for users and reduce the efforts and costs of interpreting accounting information for external market participants, resulting in increasing the quality and transparency of information, which in turn increases the quality of financial reporting.

Furthermore, comparability enables users identifying similarities and differences related to the financial performance of firms, and financial statement users' ability in comparing financial information which is vital for making optimal investment decision. Also, comparability facilitates efficient capital allocation and improve investor confidence. Therefore, investors, regulators, academics and researchers have emphasized on the importance of financial statement comparability.

On the other hand, comparability affects the cost of capital, as more precise information reduces the cost of capital (Johnstone 2016). Comparability enables

financial statement users to obtain better conclusions regarding similarities and differences between comparable firms (De Franco et al. 2011), resulting in lowering the costs of acquiring and processing information, and a significant reduction in the monitoring costs for internal and external users, including analysts and auditors.

Moreover, information risk indicates the risk that investors perceive when they know that they do not fully understand the information they are given. So, in this case comparability plays a role in decreasing information risk, which in turn decreases the cost of capital (Majeed and Yan, 2021).

But, the relation between comparability and cost of capital is not unique, as for example, the study of Huang and Yan (2020) indicated that the cost of capital decreases with comparability, if and only if, the quality of accounting information is high. This indicates that comparability by itself cannot reduce the cost of capital.

Therefore, the research intends to examine the relationship between comparability and cost of capital, especially through taking into consideration the effect of financial reporting quality on this relation.

2- Research Problem

Financial statement comparability is one of the main qualitative characteristics of accounting information that is included in the accounting conceptual framework. There are many studies that focused on the benefits of comparability, such as, reducing information asymmetry, reducing information acquisition costs, and increasing analyst following (De Franco et al. 2011), reducing credit risk (Kim et al. 2016), more efficient acquisitions decisions (Chen et al. 2018), increasing the informativeness of the stock prices (Choi et al. 2019), increasing firm value (Neel 2017), and increasing the precision of valuation (Young and Zeng 2015).

Additionally, higher comparability not only increases managers' ability to provide precise estimation of accruals but also enhances investors' understanding of the accruals (Chauhan and Kumar 2019). The main reason for these benefits is that greater comparability is associated with a richer information environment (Chen and Gong 2019).

Moreover, according to the (FASB 1980, SFAC No. 2) "the difficulty in making financial comparisons among enterprises because of the different accounting methods has been accepted for many years as the principal reason for the development of accounting standards". In other words, users' demand for comparable information drives accounting regulation. Regulators regard improving comparability as one of the main objectives of IFRS adoption (Huang and Yan 2020).

Although there are many studies that examined the advantages and consequences of financial statement comparability, however there are very few studies -according to the researcher knowledge- that examined the effect of financial statement comparability on the cost of capital, especially in the emerging markets.

Most previous studies on comparability focused only on developed economies, where developing economies have greater problems concerning information asymmetry and poor information environment. Also, there are many main differences between developed and developing economies concerning culture, financial institutions, and business practices (Majeed and Yan 2021). Therefore, this research examines the effect of financial statement comparability on cost of capital and financial reporting quality in the Egyptian environment.

In addition, there are some studies that examined the relationship between financial statement comparability and financial reporting quality, indicating a positive relationship (e.g., Barth et al. 2012; Choi and Suh 2019; Shuraki et al. 2020), and there are studies that examined the relationship between financial reporting quality and cost of capital, indicating a negative relationship (e.g., Muttakin et al. 2020; Heflin et al. 2016; Habib et al. 2019; Amrah and Hashim 2020). However, there is no study that examined the relationship between the three variables simultaneously (according to the best knowledge of the researcher). Therefore, the research problem can be stated in the following questions:

- 1- What is financial statement comparability? And how it can be measured?
- 2- Is there a relationship between financial statement comparability and cost of capital?
- 3- Is there a relationship between financial statement comparability and financial reporting quality?
- 4- Is there a relationship between financial reporting quality and cost of capital?

- 5- Is financial reporting quality affects the relation between financial statement comparability and cost of capital as an intermediate variable?

3- Research Objectives

The current research has four main objectives. First, examining the relationship between financial statement comparability and cost of capital. Second, examining the relationship between financial statement comparability and financial reporting quality. Third, examining the relationship between financial reporting quality and cost of capital. Fourth, examining the effect of financial reporting quality as an intermediate variable on the relationship between financial statement comparability and cost of capital. These objectives will be achieved using a sample of non-financial Egyptian firms listed on the Egyptian stock market.

4- Research Importance

The importance of this research in the Egyptian environment stems from its contribution to the literature and practice for the following reasons:

First: there are very few studies (to the best knowledge of the researcher) that examined the relationship between financial statement comparability and cost of capital. Therefore, this relationship stills ambiguous, and needs more investigation.

Second: there is no studies (to the best knowledge of the researcher) that examined the effect of financial reporting quality as an intermediate variable on the relation between financial statement comparability and cost of capital. So, this research is considered to be the first study to examine this effect.

Third: there are very few studies that examined these relations in emerging markets. So, this research will add a value, as it will be investigated in the Egyptian environment.

5- Research Limitations

The boundaries of the research can be stated in the following points:

First, this research investigates the effect of financial statement comparability on cost of capital. So, other factors that affect cost of capital is beyond the scope of this research.

Second, this research investigates the intermediate effect of financial reporting quality on the relation between financial statement comparability and cost of capital. So, this research is not dealing with other factors that may affect this relation.

Third, the sample used in this research is non-financial firms listed on the Egyptian stock market for the period 2017-2020. So, financial firms are excluded from the sample of this research, as the characteristics of these firms are different from firms in other industrial sectors.

Fourth, the empirical measure of financial statement comparability relies on reported earnings only, which is an income statement item. This does not mean that earnings is the only important factor, whereas balance sheet items are also important.

Fifth, this research investigates the effect of financial statement comparability on each of financial reporting quality and cost of capital and not vice versa. In other words, the reverse causality between the research variables are beyond the scope of this research.

6- Research Plan

In order to address the research problem and to achieve its objectives, the remaining parts of this research can be organized as follows:

7-Basic Concepts and Theoretical Foundation.

8-Literature Review and Hypotheses Development.

9-The Empirical Study.

10-Summary, Conclusion, Recommendations and Future Research.

7-Basic Concepts and Theoretical Foundation

In this section, the researcher presents some basic concepts which are essential for this study. In addition, the researcher provides the theoretical foundation on the research variables, which are financial statements comparability, financial reporting quality, and cost of capital.

7-1 Financial Statement Comparability

In this part, the researcher is going to present the definition of financial statement comparability, and its benefits.

7-1-1 Financial Statements Comparability Definition

According to both FASB and IASB, comparability is fundamental for the usefulness of financial information. FASB (1980) states in its (SFAC No.2) that "comparability is the quality of information that enables users to identify similarities and differences between two sets of economic phenomena".

Also, FASB (2010) in its (SFAC No.8) defines comparability as "the qualitative characteristics that enables users to identify and understand similarities in, and differences among, financial statement items". Comparability differs from other qualitative characteristics in that it does not relate to a single item, but it requires at least two items for comparison.

Cheung et al. (2010, P.156) stated that "comparability demands that identical events in two situations will be reflected by identical accounting facts and figures, and different events will be reflected by different accounting facts and figures in a way which quantitatively reflects those differences in a comparable and easily interpretable manner".

De Franco et al. (2011, P.899) defines financial statement comparability as "the degree to which similar financial statements emerge when two firm's accounting systems are applied to the same set of economic events". De Franco et al. (2011) build the definition of comparability on the idea that the accounting system is a mapping from economic events to financial statements.

Herath and Albarqi (2017, P.5) defines comparability as "the concept of allowing users to compare financial statements to determine the financial position, cash flow and the performance of the firm". This comparison allows users to compare across time and among other firms in the same period.

Chen and Gong (2019, P.3) defines comparability as "the extent to which similar economic transactions are accounted for similarly, and dissimilar transactions are accounted for differently". In other words, for a given set of economic events, comparability is the extent to which firms have similar accounting systems and hence produce similar financial statements.

The researcher can summarize the previous definitions and conclude that comparability is the qualitative characteristic that enables financial statements users to compare financial statements items. Whereas it shows the extent to which similar transactions are accounted for similarly, and different transactions are accounted for differently, for a given set of economic events.

7-1-2 Benefits of Financial Statements Comparability

All of the investors, regulators, academics and researchers, emphasize the importance of financial statements comparability and its benefits. FASB (1980, SFAC No. 2) states that investing and lending decisions cannot be made rationally if comparative information is not available.

There is a growing body of literature identifies various benefits of comparability (e.g., De Franco et al. 2011; Kim et al. 2013; Young and Zeng 2015; Kim et al. 2016; Chen et al. 2018; Choi et al. 2019; Majeed and Yan 2021). Examples of comparability benefits are the benefits to financial statements users such as: the importance of comparability in judging firm performance; improving firm's information environment as it increases the overall quantity and quality of information about a firm and its peers; providing better benchmarks for one another; making it easier to acquire and process information; and helping users to better identify and understand the similarities and differences among accounting items.

Also, there are benefits for managers such as: allowing managers to be more knowledgeable of the firm's competitors and economic conditions; increasing managers'

ability to evaluate firm performance and predict future events; and assisting managers in incorporating information into reliable forward-looking estimates.

In addition, there are benefits for analysts such as: lowering the cost of acquiring information due to the availability of information about comparable firms; increasing the overall quantity and quality of information about the firm; increasing analysts' ability to forecast firm performance; and increasing forecast accuracy.

7-2 Financial Reporting Quality

Financial reporting quality is an issue of major concern among accountants, regulators, and other users of financial reporting. Financial reporting is a mean to communicate information to the users, who use such information in assessing the economic performance and the health status of the entity. Therefore, financial reporting is considered as a guide in making decisions.

Additionally, high quality financial reporting influence capital providers and other stakeholders in making investment, credit, and resource allocation decisions, which lead to enhancing market efficiency. In this section, the researcher is going to present both of financial reporting quality definition and how to measure it.

7-2-1 Financial Reporting Quality Definition

Financial reporting is a two-party-transaction in which the issuers of the financial reporting provide them to the users, who use them with the expectation that this will help them in enhancing their financial decisions (Tasios and Bekiaris 2012). Those users include creditors, suppliers, financial analysts, and government authorities. The primary objective of financial reporting is to provide high quality financial reporting that is useful in economic decision making.

IASB (2008) explained that the objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. In other words, the main objective of financial reporting is to provide information concerning the economic entity, primarily financial in nature, and useful for economic decision making.

Although there is a general consensus among academics and practitioners that financial reporting quality is an important feature of financial reporting process, however, there is no consensus on its definition. One of the reasons why financial reporting quality is hard to define is because it is contingent on the context of a specific decision model and depends on an informative representation of underlying financial performance (Al-Sharawi 2022).

There are several definitions of financial reporting quality that have been expressed according to the objectives of each study. For instance, Jonas and Blanchet (2000, P.354) defined financial reporting quality as "the full and transparent financial information that is not designed to mislead users".

In addition, Jonas and Blanchet (2000) described two perspectives that are widely used in the assessment of financial reporting quality. The first perspective is the user needs perspective, which depends on the needs of users of financial information. In this perspective, financial reporting quality is determined on the basis of the usefulness of the financial information to the users, whereas this perspective is mainly concerned with the provision of relevant information to users for making decisions. The second perspective of financial reporting quality is the investor perspective, which depends on the shareholder or the investor protection, and aims to ensure that the information provided to users is sufficient, transparent, and competent.

Also, Verdi (2006, P.2) defined financial reporting quality as "the precision with which financial reports convey information about the firm's operations, particularly its cash flows, in order to inform equity investors".

From the above, the researcher can conclude that financial reporting quality is the precision of financial reporting, that provides complete and relevant information, which is faithfully represents the firm's financial position, in order to help financial statements users in making the appropriate decisions.

7-2-2 Measuring Financial Reporting Quality

Financial reporting quality has been of considerable concern to accounting researchers for many decades, but how to measure it, is one of the key problems. This is because the issue of financial reporting quality is an important part of the regulatory and

supervisory infrastructure, as well as it is an activity of great public interest. Therefore, the issue of its adequate and reliable measurement is of great importance.

Although financial reporting quality is a multidimensional concept, which is difficult to measure, literature usually uses earnings as the most representative measure. The origin of this concept introduced by Lev (1989), when he introduced the term "quality" in describing earnings. Lev (1989) stated that earnings are the most important information item provided in the financial statements, as high quality earnings reflect current performance, indicate future performance, and relate to the firm value. Therefore, financial reporting quality is commonly approximated by earnings quality measures. Also, inverse measurement of earnings quality can be used as indicator of earnings management activities (Barac 2021).

Many approaches have been used to measure financial reporting quality, and new approaches are still being developed. The concept of financial reporting quality is not definite, therefore, the literature uses proxies for assessing it. The reason behind the large reliance on using indirect measures is that some of the financial reporting qualities are unobservable (Al-Sharawi 2022). Consequently, this led to a wide spread of financial reporting quality proxies. There are four categories of financial reporting quality measures provided in the literature, which the researcher is going to discuss them.

7-2-2-1 Accounting-Based Measures

Accounting-based measures use only accounting information for earnings measurement, whereas they are based on the assumption that the role of earnings is the allocation of cash flows to periods by using accruals. So, the high quality earnings allocate cash flows more effectively.

Accounting-based measures are divided into accruals quality, earnings persistence, earnings predictability, and earnings smoothness (Barac 2021). With respect to **accruals quality** model, this model uses the level of earnings management as a proxy for financial reporting quality (Tasios and Bekiaris 2012). The model assumes that managers use discretionary accruals -that is accruals over which they have control- to manage earnings.

The frequently used model for earnings and accruals quality is Dechow and Dichev (2002) model, which is based on how well accruals map into cash flows. This model defines accruals quality as the residuals of the regression of working capital accruals on past, current, and future operating cash flows. In which, the model's residuals are proxies of discretionary accruals, and accruals quality is computed as the standard deviation of total abnormal accruals (discretionary accruals). So, lower values of accruals quality indicate lower level of earnings quality and poorer financial reporting quality.

According to **earnings persistence**, it is one of the measures that is based on the time-series property of earnings. Earnings persistence is achieved when current earnings are likely to be maintained in the future. Highly persistent earnings are considered sustainable, more permanent, and less transitory. Earnings persistence can be measured as the slope coefficient from autoregressive models of earnings, whereas values of slope coefficient that are close to 1 imply highly persistent earnings, while values close to zero imply highly transitory earnings (Francis et al. 2004).

With respect to **earnings predictability**, it can be defined as the ability of current earnings to predict future earnings (Barac 2021). Therefore, earnings can be considered of high quality, if they can accurately predict future cash flows. Earnings predictability measures the accuracy of earnings in the prediction of future cash flows because one of the purposes of financial reporting is to provide information useful for assessing future financial performance, which can be operationalized by future cash flows. Earnings predictability can be measured as the standard deviation of estimated error from the equation of earnings persistence. As, lower variance and higher explanatory power values indicate higher predictability of earnings and better financial reporting quality.

Lastly in the group of accounting-based measures is **earnings smoothness**, which is based also on the time-series property of earnings, and it is also referred to "earnings volatility". Earnings smoothness means that when earnings are less volatile, they are more predictable and persistent. Earnings smoothness can be measured by dividing the standard deviation of earnings by the standard deviation of operating cash flows, where higher values indicate less smoothness and more volatility earnings, which means low financial reporting quality.

The main advantage of accounting-based measures is that they are calculated based on data from annual reports only. On the other hand, the main disadvantage is that financial reporting quality can be deteriorated by intentional or unintentional financial reporting misstatement (Barac 2021). Moreover, Francis et al. (2004) found that accounting-based measures have a stronger cost of equity effect than market-based measures, with accrual quality measures having the largest effect.

7-2-2-2 Market-Based Measures

Market-based measures are characterized by using market data in earnings measurement calculations. These measures include value relevance models, timeliness, and conservatism. **Value relevance** models measure the association between accounting figures and stock market reactions, in order to assess the quality of financial reporting information. Value relevance also known as earnings response coefficient (ERC), whereas higher ERC means that earnings are better reflect of performance. When changes in accounting information correspond to changes in market value of the firm (stock prices), we can say that earnings information provides relevant and reliable information.

Market-based measures also include timeliness and conservatism, which are used to assess how close reported accounting income is to economic income approximated by stock returns. **Timeliness** is the extent to which current earnings reflect value relevant information, where **conservatism** is the asymmetric timeliness of good and bad news in earnings, or the asymmetric timely recognition of losses relative to gains. Conservatism earnings reflect bad news more quickly than good news. So, conservatism causes more timely recognition of losses than gains and improve the quality of accounting information.

7-2-2-3 Benchmarking

There is a third category of measuring financial reporting quality, which measures the quality of specific elements in annual financial reports as "a benchmark" for the overall financial reporting quality. It thus examines the influence of presenting specific information in the annual reports on the decisions made by the users of such information, by focusing on both financial and non-financial information.

Examples of specific elements in the financial reports that can be considered as benchmark include: the examination of restatements in the financial statements, the use of narratives in the annual reports, the use of graphs in the annual reports, content analysis examining the letters from the chief executive officer in the annual reports, and the examination of auditor's report and going concern issues. In sum, the proxies in this category varies widely depending on which element of the financial reports is examined by the researcher.

The main advantages of benchmarking are that it is simple, easy to calculate, and provides a direct measure of financial reporting quality. On the other hand, the main disadvantages are that it has a partial focus, and does not provide a comprehensive overview of total financial reporting quality.

7-2-2-4 Operationalization of the Qualitative Characteristics of Financial Reporting Quality

Lastly, a fourth category of measuring financial reporting quality was provided by Beest et al. (2009), which is the operationalization of the qualitative characteristics of financial reporting quality. It aims to assess the qualities of different financial and non-financial information of financial reports in order to determine their usefulness.

A key prerequisite for achieving financial reporting quality is the adherence to the objectives and the qualitative characteristics of financial reporting information. Qualitative characteristics can be defined as "the attributes that meet the decision usefulness of financial information (Barac 2021). The conceptual framework for financial reporting that released by the IASB (2008) has listed these attributes as: relevance, faithful representation, comparability, understandability and timeliness.

The fundamental qualitative characteristics can be represented by relevance and faithful representation, while the enhancing qualitative characteristics can be represented by understandability, comparability and timeliness. Enhancing qualitative characteristics are complementary to the fundamental qualitative characteristics, and distinguish more useful from less useful information.

It has been argued that using the qualitative characteristics models provide a direct and better measure of financial reporting quality (Mbobo and Ekpo 2016). However, many recent studies still prefer using other accounting-based methods such as

the discretionary accruals as a proxy for financial reporting quality. This might be due to the difficulty of operationalising the qualitative characteristics.

7-3 Cost of Capital

The information environment is of great importance in the field of finance, and has many effects in financial accounting literature. Information quality is an important factor regarding the cost of capital decisions, as financial statements play an important role in reducing information asymmetry between firms and investors, because they present more accurate pictures of the firm position. Armstrong et al. (2011) found that when the number of shareholders is smaller, firms with high information asymmetry earn significantly higher excess returns than do firms with low information asymmetry. In the next section, the researcher is going to present the cost of capital definition; factors affecting the cost of capital; and components of cost of capital.

7-3-1 Cost of Capital Definition

A firm's cost of capital is the investor's opportunity cost of investing his or her capital in that firm. Apergis et al. (2012, P.323) defined cost of capital as "the weighted average, where the weights are determined by the value of the various sources of capital". Apergis et al. (2012, P.323) defined cost of capital also as "the expected return on a firm's stock".

Lambert and Verrecchia (2015, P.444) defined cost of capital as "the extent to which investors discount price at the beginning of the period relative to the expected value of the firm's cash flow". Also, Huang and Yan (2020, P.306) defined cost of capital as "the expected return on the firm's equity". In other words, cost of capital is the cost that is required by new investors to invest in the firm's stock.

In addition, Farag et al. (2020, P.290) defined cost of capital as "the weighted average cost of the different costs of capital, such as equity and debt". From the above, the researcher can conclude that, cost of capital is the expected return on the firm's equity and is the weighted average cost of all sources of capital.

7-3-2 Factors Affecting Cost of Capital

There are many factors that affect the cost of capital. For example, the study of Apergis et al. (2012) indicated that accounting information affect the firm's cost of

capital through two ways: a direct way and an indirect way. The direct way, is when the higher degree of accounting information affects the assessment generated by market participants about the firm's cash flows. The indirect way, is when the higher degree of accounting information affects the firm's real decisions.

In addition, the level of disclosure affects the firm's cost of capital, whereas, richer disclosures lead to a good relationships with investors. These good relationships depend on information relevance to investors. In other words, good relationships with investors are part of effective financial policy (Muttakin et al. 2020). The main idea is that higher levels of disclosure lead to a reduction in information asymmetry between managers and investors, and thus causing a reduction in the cost of capital (Lopes and De Alencar 2010).

The study of Lambert and Verrecchia (2015) explained that greater market illiquidity can mitigate the benefits of economic phenomena that reduce the cost of capital, for example, the benefits that arise from an increase in investor's average precision. While, greater illiquidity can magnify the bad effects of economic phenomena that increase the cost of capital, for example, the effect that arises from an increase in investors competition. In other words, the effect of information asymmetry is stronger in less liquid markets. This means that the level of liquidity is an important variable affecting cost of capital.

Also, the level of conservatism affects the cost of capital, as, the study of Li (2015) found a negative association between conservatism and both cost of equity and cost of debt. One standard deviation increase in conservatism reduces the cost of equity by 47 points, and reduces the cost of debt by 21 points.

7-3-3 Components of Cost of Capital

There are two main components of cost of capital, the cost of equity and the cost of debt (Elhenawy 2018), as follows:

7-3-3-1 Cost of Equity Capital

Obiedallah et al. (2021) refer to the cost of equity capital as the asset's required return, which can be explained by the minimum return that equity holders require based on the asset's risk. So, more risky asset will have a higher required return. The required

return is also called the opportunity cost for investing in the asset. Therefore, if the expected return is greater than the required return, the opportunity of investment is more attractive (and vice versa).

Botosan (2006, P.32) defined cost of equity as "the minimum rate of return, equity investors require for providing capital to the firm". It is comprised of the risk free rate of interest and a premium for the firm's non-diversifiable risk. Botosan (2006, P.32) also defined cost of equity as "the risk-adjusted discount rate that investors apply to expected future cash flows to arrive at current stock price". The literature sometimes refers to the cost of equity as the "expected" cost of equity. The reason for this it is a forward-looking concept, which is not directly observable in the market place.

From the above, the researcher can conclude that the cost of equity is the minimum rate of return required by investors for providing capital to the firm, based on the asset's risk.

7-3-3-2 Cost of Debt

The debt is used to finance the firm needs that are greater than the equity. As, raising debt capital is less complicated, because the firm is not required to comply with state and securities laws and regulations, but the lender is entitled only to repayment of the principal of the loan plus interest, without any direct claim on future profits of the business (Essawy 2023).

Gray et al. (2009, P.55) defined cost of debt as "the effective rate that a firm pays on its long-term debt, in which the firm will use various bonds, loans and other forms of debt". While, Li (2015, P.558) stated that the cost of debt is "the cost that firms incur when obtaining external financing from lenders or other debt providers". Also, Essawy et al. (2023, P.19) defined cost of debt as "the financial cost associated with new funds raised through long-term borrowing". From the above, the researcher can conclude that the cost of debt is the effective rate that incurred by the firm, in order to raise new funds, through external financing.

8-Literature Review and Hypotheses Development

This section presents some previous studies that demonstrate the theoretical basis between the research variables, and help in deriving the research hypotheses.

8-1 The Relationship between Financial Statement Comparability and Cost of Capital and the Development of the First Research Hypothesis

According to Financial Accounting Standards Board (2010) in its (SFAC No.8), comparability is the quality of information that enables users to identify similarities and differences between two sets of economic phenomena, thus making more efficient investment decisions. Therefore, investors demand relatively lower expected returns, and hence resulting in a lower cost of equity capital (Cho et al. 2015).

Moreover, financial statement comparability improves the acquisition and processing of financial information, which results in lower information asymmetry, and creating a transparent information environment, which in turn makes evaluating the financial position of a firm and monitoring the activities of its managers more easier (Majeed and Yan 2021). So, the researcher can conclude that financial statement comparability is negatively associated with the cost of capital.

The study of Cho et al. (2015) examined the effect of financial statement comparability on the cost of equity capital. This study used a sample of firms listed on the Korean stock exchange during the period 2007-2010. They found that there is a significant negative association between financial statement comparability and the cost of equity capital.

Moreover, the study of Imhof et al. (2017) investigated how financial statement comparability is affecting the cost of equity capital, they used cross-sectional regressions for a sample of 27,438 firm-year observations in USA during the period 1990-2014. The study found a significant negative association between comparability and cost of equity, even in the presence of control variables such as earnings quality. The study highlighted that comparability reduces investors' information risks, and hence reduces their required rates of return. They also found that comparability is more strongly negatively associated with cost of equity for firms with high information asymmetry, and firms with equity securities traded in an imperfect markets.

In addition Bordeman et al. (2019) examined whether financial statement comparability affects the cost of capital in the market for seasoned equity offerings (SEO), using a sample of US firms during the period 1984-2014. The study found that comparability is negatively associated with SEO costs. The authors concluded that comparability allows investors to better assess the financial health of the firm, expending less effort, and experience less adverse selection risk, thus lowering the costs of SEO. In other words, comparability reduces information asymmetry, and increases information precision and transparency. These results provide evidence on the consequences of financial reporting quality in capital markets.

Furthermore, Elhoshy (2020) addressed the relationship between financial statement comparability and the cost of equity capital. The sample included non-financial firms listed on the Egyptian stock exchange for the period 2013-2018. The study found a significant negative relationship between comparability and cost of equity capital.

In this context, Huang and Yan (2020) examined how financial statement comparability affects the cost of capital and investor welfare. They built a statistical model depending on a two-firm economy. The study found that the cost of capital decreases with comparability if the quality of accounting standards is high.

In summary, this section provides an evidence on the negative relation between financial statement comparability and cost of capital. The main idea behind this evidence is that financial statement comparability reduces information asymmetry, increases information transparency, which leads to make more efficient investment decisions. The researcher will measure the cost of capital using cost of equity. Therefore, the researcher can develop the following hypothesis:

H1: There is a significant negative relationship between financial statement comparability and cost of Equity.

8-2 The Relationship between Financial Statement Comparability and Financial Reporting Quality and the Development of the Second Research Hypothesis

Financial statement comparability reduces the cost of acquiring and processing information, thus increasing the quantity and quality of information (Chen and Gong 2019). Managers use financial reports of peer firms to determine strategic choices,

mitigate uncertainty, and for benchmarking purposes. In other words, managers depend on financial reporting to modify their actions accordingly.

In this context, Chen and Gong (2019) examined the impact of financial statement comparability on financial reporting quality. Comparability was measured using the model of De Franco et al. (2011). In order to measure financial reporting quality, four measures were used: financial restatements, the accruals quality model that was modified by Dechow and Dichev (2002), earnings persistence, and audit fees. They used a sample from compustat for the period 1988-2017, whereas they required firm-year observations in each of the 48 industry classifications.

The results showed that financial statement comparability is associated with higher financial reporting quality. They found that comparability is negatively related to the likelihood of a financial restatement, audit fees, and absolute discretionary accruals. They also found that comparability is positively related to the persistence of discretionary accruals.

The authors stated that as comparability increases, managers will be better able to report accruals that are more related to the firm activities. They stated also that discretionary accruals of more comparable firms are less positively correlated with current returns and less negatively correlated with future returns. They explained that financial statement comparability improves the pricing efficiency of discretionary accruals. In addition, they found evidence that comparability is positively associated with managerial forecast accuracy and precision, indicating that comparability improving the ability of managers to predict future firm performance.

Furthermore, Choi and Suh (2019) examined the effect of financial statement comparability on the design of chief executive officer (CEO) compensation structure. Financial statement comparability was measured using De Franco et al. (2011) model, the sample used in this study included all firm-year observations that have CEO compensation data from the COMPUSTAT, that yielded 5,231 firm year observations over the period 1998-2014. The study found that financial statement comparability is positively associated with CEO equity-based compensation intensity and pay-performance sensitivity. They also found that the impact of financial statement comparability on CEO compensation contract increases with information asymmetry. The authors explained that the financial statement comparability is the quality of

financial reporting that facilitates the use of CEO compensation in a poor information environment.

Similarly, the study of Shuraki et al. (2020) aimed to examine the association between financial statement comparability, financial reporting quality and audit opinions. The sample used in the study included firms listed on Tehran stock exchange during 2015-2019. Financial statement comparability was measured using De Franco et al. (2011) model, and financial reporting quality was measured using Hutton et al. (2009) model. According to Hutton et al. (2009), the primary measure of firm performance is earnings (or net income) which are associated with economic transactions that occurred during the reporting period. So, the authors used discretionary accruals as a measure for earnings quality which is a proxy for financial reporting quality.

The authors found a strong negative association between financial statement comparability, financial reporting quality, and audit opinion. Whereas, they found a negative association between comparability and the proxies for audit opinion, as well as finding a negative association between financial reporting quality and audit opinions. They explained that higher financial statement comparability, and higher financial reporting quality increase auditor tendency to issue unmodified audit opinion.

Moreover, the study of Ejazi et al. (2022) examined the effect of financial statement comparability on financial reporting quality measured by accruals quality, for a sample of Iranian firms during the period 2014-2020, with a total of 630 observations. The results showed that higher financial statement comparability enhances financial reporting quality.

In summary, this section provided evidence on the positive relation between financial statement comparability and financial reporting quality. The idea behind this relationship is that financial statement comparability enhances the information environment, providing more reliable information, which leads to produce high quality reporting. Because the researcher will measure financial reporting quality using accruals quality. Therefore, the researcher can develop the following hypothesis:

H2: There is a significant positive relationship between financial statement comparability and accruals quality.

8-3 The Relationship between Financial Reporting Quality and Cost of Capital and the Development of the Third Research Hypothesis

Financial statement comparability is an important characteristic of financial reporting that enhances the significance of accounting information. Many researchers have investigated the negative relation between financial reporting quality and the cost of equity capital, arguing that investors demand higher expected return. This is due to information asymmetry resulting from poor quality of financial reporting (Cho et al. 2015), which leads to higher cost of equity capital.

For example, Heflin et al. (2016) addressed the relations between disclosure quality, earnings quality, and three measures of the cost of capital (cost of equity, cost of debt, and bid-ask spreads). The study covered the period 1986-1996, while the sample size was for the three analyses of cost of equity, cost of debt, and bid-ask spread were 1,776, 1,354, and 626 firm-year observations respectively.

The study found that higher disclosure quality is associated with lower costs of equity, lower costs of debt, and smaller equity market bid-ask spreads. Although the study highlighted that disclosure quality has a first-order effect on cost of capital, but it highlighted also that earnings quality is an important factor in explaining cost of capital.

Similarly, the study of Eliwa et al. (2016) examined the association between earnings quality and the cost of equity capital. Earnings quality was measured using four proxies; accruals quality, earnings persistence, earnings predictability, and earnings smoothness, while earnings-price ratio was used as a proxy for the cost of equity. The study used a sample of non-financial firms listed in the London stock exchange during the period 2005-2011.

The study found a significant negative association between each of earnings quality proxies separately and the cost of equity. They highlighted that the least consistent association was found for smoothness proxy, but the predictability proxy is the most consistent association, followed by accruals quality, then persistence, and finally smoothness.

In addition, the study of Bekheet et al. (2019) is also very important, because it was conducted in Saudi Arabia, so, it provides evidence concerning emerging markets. The study examined the relationship between earnings quality and cost of equity. Its

sample included all non-financial firms listed in Saudi Arabian stock exchange, for the period 2015&2016, which yielded 183 observations for 91 firms. Cost of equity was measured using the inverse of the price-earnings ratio of Omran and Pointon (2004). While, earnings quality was measured using four proxies; accruals quality, earnings persistence, earnings predictability, and earnings smoothness.

The results showed that there is a significant relationship between earnings quality and cost of equity, when using accruals quality and earnings persistence as proxies for earnings quality. But, when using the other two proxies, which are earnings predictability and earnings smoothness, the effect was insignificant.

In summary, this section provided evidence on the negative relation between financial reporting quality and cost of capital, the main idea behind this relation is that quality of financial reporting reduces information asymmetry, and produces more reliable information, which in turn reduces the cost of capital. Because the researcher will measure financial reporting quality using accruals quality, and will measure cost of capital using cost of equity. Therefore, the researcher can develop the following hypothesis:

H3: There is a significant negative relationship between accruals quality and cost of equity.

8-4 The Intermediate Effect of Financial Reporting Quality on the Relationship between Financial Statement Comparability and Cost of Capital and the Development of the Fourth Research Hypothesis

According to the researcher knowledge, there is no previous studies that investigated the three variables of the study simultaneously. The researcher in this study will try to test the intermediate effect of financial reporting quality on the relation between financial statement comparability and cost of capital.

The researcher expects that higher levels of financial statement comparability lead to improving financial reporting quality, which in turn lead to reducing the cost of capital. Therefore, the researcher expects financial reporting quality to intermediates the relationship between financial statement comparability and cost of capital.

As, the researcher will use cost of equity in measuring cost of capital, and accruals quality in measuring financial reporting quality. Therefore, the researcher can develop the following hypothesis:

H4: Accruals quality intermediates the relationship between financial statement comparability and cost of equity.

9-The Empirical Study

This section presents the empirical study through testing the study hypotheses which were derived in the previous section, in order to reach a conclusion about the extent to which the results of this research agree or contradict with the findings of prior studies, as follows:

9-1 Objectives of the empirical study

Objectives of this empirical study are to examine the relationship between financial statement comparability and cost of capital for a sample of Egyptian firms listed in the Egyptian stock market. In addition, examining whether financial reporting quality affects the relation between financial statement comparability and cost of capital as an intermediate variable.

9-2 Population and sample selection

The population of this research is the Egyptian firms listed in the Egyptian stock market for four years from 2017 to 2020, after excluding banking, insurance and other financial sectors¹.

The sample was selected according to a number of standards which are: (1). The sample firm has to be listed in the Egyptian stock market over the period 2014-2020, and the firm's financial reports must be available over this period, because measuring the independent variable of this research (which is financial statement comparability) needs data over a period of four years –the current year and the three previous years- so, financial data must cover the period of 7 years. (2). Each sector must have at least two firms, this is a requirement for measuring financial statement comparability. (3). The

¹ Banking, insurance, and other financial sectors were excluded from the scope of this research, because the characteristics of firms in these sectors are different from firms in other sectors in terms of financial statements profitability measures and liquidity assessment (Zeitun and Tian 2007).

financial year of all sample firms ends on 31 December of each year. (4). The currency of financial reports is the Egyptian pound. (5). Sample firms don't belong to financial sectors.

After performing sample selection standards, the sample size is 70 firms belongs to 10 sectors, consisting of 280 observations. Table (1) represents the 10 sectors included in this research and the number of sample firms in each sector, in addition to the number of observations in each year.

Table (1): Number of Sample Firms and its Observations According to Sectors

Sector	Number of Firms				Total Observations	Percent
	2017	2018	2019	2020		
Basic Resources	4	4	4	4	16	5.71%
Chemicals	5	5	5	5	20	7.14%
Construction and Materials	9	9	9	9	36	12.85%
Industrial Goods and Service and Automobiles	4	4	4	4	16	5.71%
Travel and Leisure	7	7	7	7	28	10%
Telecommunications	2	2	2	2	8	2.85%
Personal and Household Products	5	5	5	5	20	7.14%
Healthcare and Pharmaceuticals	6	6	6	6	24	8.57%
Food and Beverages	11	11	11	11	44	15.71%
Real Estate	17	17	17	17	68	24.28%
Total	70	70	70	70	280	100%

***Source:** developed by the researcher.

Financial data used in the empirical study was collected using annual reports of the sample firms, and its disclosure reports and stock prices which were available at some specialized websites on the internet like the site of Misr Information Services and Trading (MIST); the site of Misr Mubasher Information; and the site of the Egyptian Exchange.

9-3 Variables measurement

This research has three types of variables as follows: (1). Independent variable, which is financial statement comparability; (2). Dependent variable, which is cost of capital; and (3). Intermediate variable, which is financial reporting quality. The

researcher can summarize study variables and study hypotheses in figure (1), which represents the research model. The researcher will measure study variables taking into consideration the way of measurement used in the previous studies as follows:

9-3-1 Independent Variable

The independent variable in this research is financial statement comparability. Consistent with prior studies (e.g., Chen and Gong 2019; Shuraki et al. 2020), the researcher will use the model of De Franco et al. (2011) to measure financial statement comparability.

According to De Franco et al. (2011), comparability is the degree to which earnings change over time for two firms in the same industry. That means, if two accounting systems are similar, their output should be comparable (Shuraki et al. 2020). Therefore, the more comparable the two accounting systems of the two firms, the smaller is the gap between their estimated earnings. So, according to De Franco et al. (2011) comparability is the negative value of the absolute difference between predicted earnings for firm i and firm j using the 16 previous quarters. But, in this research, the researcher uses annual financial data. So, the researcher will use the model for 4 years² as follows:

$$\text{Comp}_{ijt} = -\frac{1}{4} * \sum_{t-3}^t |E(\text{earnings})_{iit} - E(\text{earnings})_{ijt} |$$

Where, Comp_{ijt} is financial statement comparability between firm i and firm j; $E(\text{earnings})_{iit}$ ³ is the predicted earnings of firm i, using the accounting system of firm i, and the stock return of firm i, in the period t; and $E(\text{earnings})_{ijt}$ is the predicted earnings of firm j, using the accounting system of firm j, and the stock return of firm i, in the period.

² De Franco et al. (2011) used the previous 16 quarters in their model for calculating financial statement comparability, because they were using financial data quarterly. And many studies followed them in using quarter data (e.g., Fang et al. 2016; Chen and Gong 2019; Choi et al. 2019). But, in this research, the researcher uses annual data, following some previous studies (e.g., Neel 2017; Su et al. 2018; Elhoshy 2020; Khedr 2020). So, the model of calculating financial statement comparability in this research, uses the period of 4 years instead of 16 quarters.

³ Earnings is calculated as (net income before tax / market value of equity at the beginning of the period). where, market value of equity at the beginning of the period is calculated as (share price at the beginning of the period * number of shares at the beginning of the period).

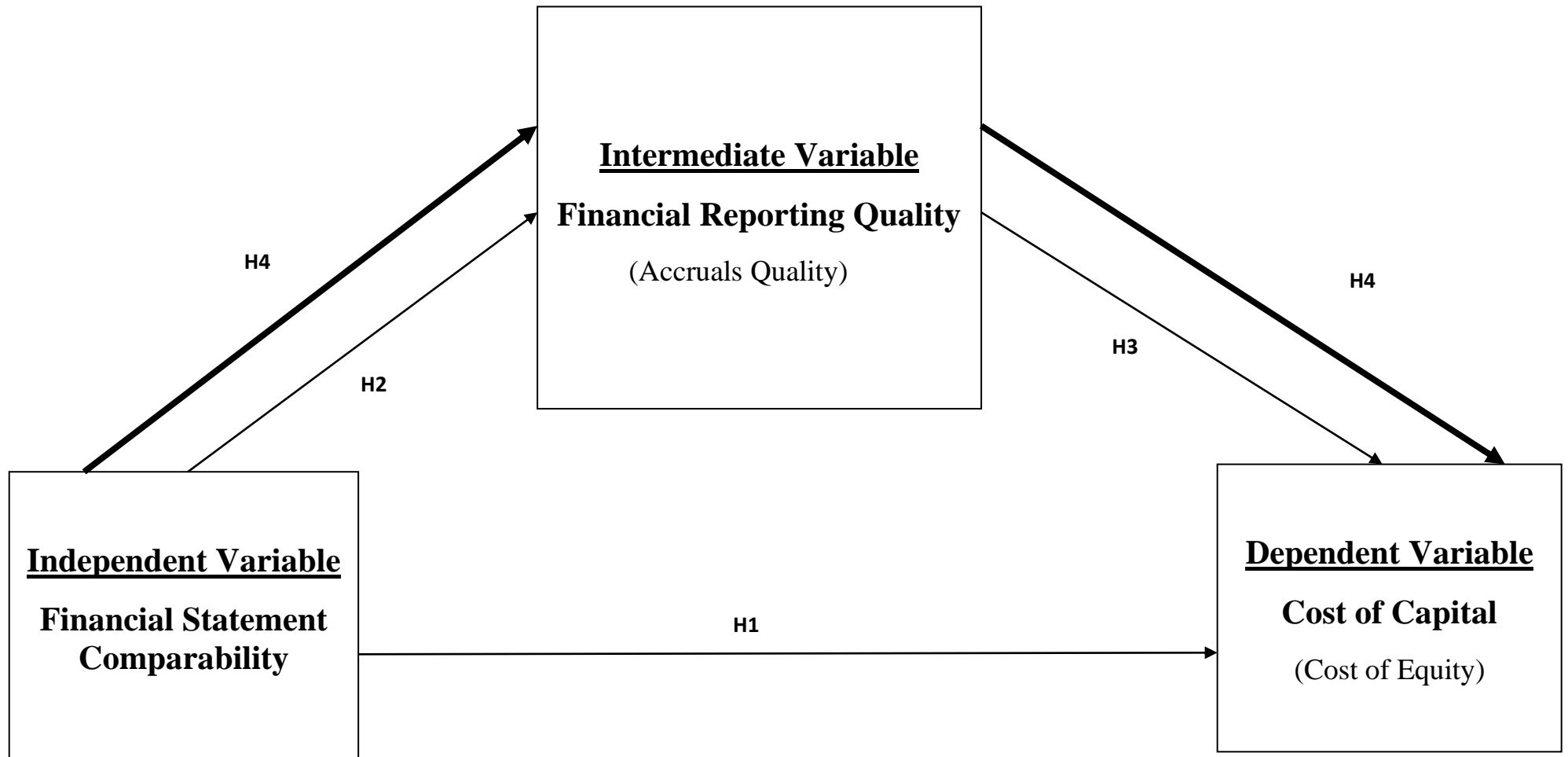


Figure (1): The Research Model

***Source:** developed by the researcher.

$$E(\text{earnings})_{it} = \alpha_i + \beta_i \text{Return}_{it}$$

$$E(\text{earnings})_{ijt} = \alpha_j + \beta_j \text{Return}_{it}$$

Where, Return_{it}^4 is the stock return of firm i in the period t . The researcher will calculate comparability for each firm i and firm j pair within the same sector. Then, the researcher will calculate the average of (Comp_{ijt}) for each firm in the same sector, to create a firm-year measure of comparability. So, greater values of (Comp_{ijt}) indicates greater financial statement comparability between pair firms.

9-3-2 Dependent Variable

The dependent variable in this research is cost of capital, which will be measured using cost of equity. According to previous studies (e.g., Bekheet et al. 2019; Elhoshy 2020; Khedr 2020), the researcher will measure cost of equity using the model of Omran and Pointon (2004) as follows:

$$K_e^c = 1 / (\text{PE ratio} - (e_0 - d_0) / e_0)$$

Where, k_e^c is cost of equity capital; PE ratio is the ratio of share price at the end of the period to its earnings; e_0 is earnings per share for the period; and d_0 is dividends per share for the period.

9-3-3 Intermediate Variable

The intermediate variable in this research is financial reporting quality, which the researcher measures it using accruals quality. Accruals quality is measured through mapping accruals into cash flows. In other words, through measuring the standard deviation of residuals from regressing working capital accruals on past, current, and future cash flows from operations. So, large standard deviations of residuals indicate poor accruals quality. The researcher will follow Francis et al. (2004) in measuring accruals quality, who used the model of Dechow and Dichev (2002) as follows:

$$(\text{TCA}_{i,t} / \text{assets}_{i,t}) = \alpha_{0,i} + \beta_{1,i} (\text{CFO}_{i,t-1} / \text{assets}_{i,t}) + \beta_{2,i} (\text{CFO}_{i,t} / \text{assets}_{i,t}) + \beta_{3,i} (\text{CFO}_{i,t+1} / \text{assets}_{i,t}) + v_{i,t}$$

⁴ Return is calculated as ((share price at the ending of the period – share price at the beginning of the period) + share dividends) / share price at the beginning of the period.

Where, $TCA_{i,t}$ is total current accruals in year t, which equals $(\Delta CA_{i,t} - \Delta CL_{i,t} - \Delta cash_{i,t} + \Delta STDEBT_{i,t})$, as $\Delta CA_{i,t}$ is change in current assets of firm i between year t-1 and year t, $\Delta CL_{i,t}$ is change in current liabilities of firm i between year t-1 and year t, $\Delta cash_{i,t}$ is change in cash of firm i between year t-1 and year t, and $\Delta STDEBT_{i,t}$ is change in short term debts of firm i, between year t-1 and year t. While, $assets_{i,t}$ is average total assets of firm i in year t and t-1; $CFO_{i,t-1}$ is operating cash flow of firm i in year t-1; $CFO_{i,t}$ is operating cash flow of firm i in year t; and $CFO_{i,t+1}$ is operating cash flow of firm i in year t+1.

If a firm has high residuals for a period of time, then the standard deviation of these residuals will be small, so the firm will have high accruals quality, as a result of lower uncertainty about its accruals (Eliwa et al. 2016). Therefore, the researcher will multiply the values of standard deviation of residuals (accruals quality) by -1. In this case, higher values of standard deviation of residuals, means higher accruals quality, and in turn higher financial reporting quality.

9-4 Descriptive statistics

The descriptive statistics of the study variables for the 280 observations are presented in the table (2).

Table (2): Descriptive Statistics for Study Variables

Variables	N*	Minimum	Maximum	Mean	Standard Deviation
Comparability	280	-3.4156	-.0719	-.3314	.4352
Cost of Equity	280	-3.3938	142.8190	.6618	8.5683
Accruals Quality	280	-.390	.0010	-.0794	.0624
*N is the total number of observations for the four years of the study.					

Table (2) shows the minimum; maximum; mean and standard deviation values for study variables. These descriptive statistics indicate that the value of mean for each of financial statement comparability and cost of equity are -.3314 and .6618 respectively. Also, the standard deviation for these two variables are .4352 and 8.5683, which are higher than the values of the mean.

In addition, the researcher noticed that the difference between the maximum value and the minimum value for cost of equity is high, which indicates high dispersion between sample firms, and this is normal as the sample firms are from different industries.

9-5 The statistical techniques

The researcher will use a number of statistical techniques to investigate the research hypotheses in order to get the research results. First, the researcher will use Pearson correlation analysis, which is a parametric method that shows the degree of correlation between each pair of variables. Then, the researcher will use structure equation modeling (SEM) in investigating the relation between study variables, as this model helps in investigating many relations at the same time, and also it is preferable from most previous studies to test the effect of the intermediate variable. So, the researcher will use the path analysis -one of the SEM techniques- to test these relations, using AMOS program in SPSS software, version number 26.

The path analysis technique indicates three types of effects as follows; **(1). The direct effect**, which measures the effect of the independent variable on the dependent variable, without considering the effect of any other variables affecting these two variables. **(2). The indirect effect**, which measures the effect of the independent variable on the dependent variable through the existence of the effect of the intermediate variable, as this effect will be the product of multiplying the coefficients of the two pathways (the first pathway is from the independent variable to the intermediate variable and the second pathway is from the intermediate variable to the dependent variable). **(3). The total effect**, which is the sum of the direct and the indirect effects.

Accordingly, there is four types of mediation effects (Little et al. 2007). **First: the fully mediation effect**, when there is a significant relationship between the independent variable and the intermediate variable; also there is a significant relationship between the intermediate variable and the dependent variable; but there is insignificant relationship between the independent variable and the dependent variable.

Second: the partial mediation effect, when there is a significant relationship between independent variable and intermediate variable; also there is a significant

relationship between intermediate variable and dependent variable; and there is a significant relationship between independent variable and dependent variable.

Third: *the inconsistent mediation effect*, when there is a significant relationship between the independent variable and the intermediate variable; also there is a significant relationship between the intermediate variable and the dependent variable; and there is a significant relationship between the independent variable and the dependent variable, but this relationship differs in its direction (whether it is positive or negative) from other relations.

Fourth: *no mediation*, which happens in three cases; (1): if the relationship between the intermediate variable and the dependent variable is insignificant, but the relationship between the independent variable and the dependent variable is significant. (2): if the relationship between the independent variable and the intermediate variable is insignificant, but the relationship between the intermediate variable and the dependent variable is significant. (3): if the relationships between the three variables (independent, intermediate, and dependent) are all insignificant.

9-6 Statistical results

This section presents results of the statistical techniques explained in the previous section, as follows:

9-6-1 Results of Pearson Correlation

Pearson correlation coefficients will help to investigate the strength and the direction of the relation between each pair of the study variables, as the research has three direct relations; the relation between the independent variable and the dependent variable; the relation between the independent variable and the intermediate variable; and lastly the relation between the intermediate variable and the dependent variable.

9-6-1-1 Pearson Correlation between Independent Variable and Dependent Variable

The independent variable in this research is financial statement comparability, and the dependent variable is cost of capital, which will be measured in the basic test using cost of equity. Table (3) presents the Pearson correlation coefficient between financial statement comparability and cost of equity as follows:

Table (3): Pearson Correlation between Financial Statement Comparability and Cost of Equity

		cost of equity	Comparability
cost of equity	Pearson Correlation	1	-.958*
	Sig. (2-tailed)		.027
	N	280	280
Comparability	Pearson Correlation	-.958*	1
	Sig. (2-tailed)	.027	
	N	280	280

* Correlation is significant at the 0.05 level (2-tailed).

Table (3) indicates that there is a significant negative relationship between financial statement comparability and cost of equity as $R = -0.958$ at $p\text{-value} = 0.027$, and this relation is a strong relationship as the value of R is near to 1.

9-6-1-2 Pearson Correlation between Independent Variable and Intermediate Variable

The independent variable is financial statement comparability, while the intermediate variable is financial reporting quality, which is measured using accruals quality. The Pearson correlation between financial statement comparability and accruals quality will be introduced in table (4).

Table (4): Pearson Correlation between Financial Statement Comparability and Accruals Quality

		ACCR	comparability
ACCR	Pearson Correlation	1	.514*
	Sig. (2-tailed)		.039
	N	280	280
Comparability	Pearson Correlation	.514*	1
	Sig. (2-tailed)	.039	
	N	280	280

* Correlation is significant at the 0.05 level (2-tailed).

- ACCR: is accruals quality.

Table (4) indicates that there is a significant positive relationship between financial statement comparability and accruals quality as $R = 0.514$ at $p\text{-value} = 0.039$, and this relation is a moderate relationship as the value of R is near to 0.5.

9-6-1-3 Pearson Correlation between Intermediate Variable and Dependent Variable

The intermediate variable is financial reporting quality which is measured using accruals quality. While, the dependent variable is cost of capital, which is measured using cost of equity. The Pearson correlation between accruals quality and cost of equity will be introduced in table (5).

Table (5): Pearson Correlation between Accruals Quality and Cost of Equity

		cost of equity	ACCR
cost of equity	Pearson Correlation	1	-.850*
	Sig. (2-tailed)		.011
	N	280	280
ACCR	Pearson Correlation	-.850*	1
	Sig. (2-tailed)	.011	
	N	280	280

* Correlation is significant at the 0.01 level (2-tailed).

Table (5) indicates that there is a significant negative relationship between accruals quality and cost of equity as $R = -0.850$ at $p\text{-value} = 0.011$ (at 0.01 significance level), and this relation is a strong relationship as the value of R is near to 1.

9-6-2 Results of Fit Indices of Structural Equation Modeling

Structural equation modeling (SEM) has become one of the most popular techniques of choice for researchers nowadays. One important point that should be determined is the issue of how the model best represents the data, this is known as "model fit". Assessing whether a specified model fits the data is one of the most important steps in structural equation modeling. There are some indices that determine how well the model represents the sample data. In other words, these indices determine whether the model is fit or not (Hooper et al. 2008). The researcher will summarize these indices; its acceptable ranges and whether the proposed model is fit or not according to these indices in table (6).

Table (6): Fit Indices of Structural Equation Modeling

Index	Abbreviation	The acceptable range	The proposed model	Fit or not?
Chi-Square X ²	CMIN/DF	<ul style="list-style-type: none"> • Less than 5 is fit. • Less than 2 is completely fit. 	1.973	Fit
Root Mean Square Error of Approximation	RMSEA	<ul style="list-style-type: none"> • Less than or equal 0.05 is completely fit. • Between 0.05 and 0.1 is fit. • Greater than 0.1 is not fit. 	0.054	Fit
Goodness of Fit Index	GFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.90 is a good fit. 	0.956	Fit
Adjusted Goodness of Fit Index	AGFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.90 is a good fit. 	0.983	Fit
Root Mean Square Residual	RMR	<ul style="list-style-type: none"> • More than 0. • Less than 0.1. 	0.076	Fit
Normed Fit Index	NFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.95 is a good fit. 	0.971	Fit
Comparative Fit Index	CFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.95 is a good fit. 	1.000	Fit

***Source:** developed by the researcher.

By analyzing the acceptable ranges of fit indices of structural equation modeling, the researcher found that the proposed model is statistically fit.

9-6-3 Results of Hypotheses Testing

Table (7) summarizes the statistical results for the direct effect of financial statements comparability on cost of equity (hypothesis 1); the direct effect of financial statement comparability on financial reporting quality (hypothesis 2); and the direct effect of financial reporting quality on cost of equity (hypothesis 3).

Table (7): The Statistical Results of H1, H2, and H3

Hypotheses	Path	Direct Effect	
		Path Coefficients	P-value
H1	Comparability ---> Cost of Equity	-0.36	0.017
H2	Comparability ---> ACCR	1.02	0.000
H3	ACCR ---> Cost of Equity	-0.43	0.000

9-6-3-1 Results of Testing the First Hypothesis

The first hypothesis tests whether there is a significant negative relationship between financial statement comparability and cost of equity. The statistical results in table (7) indicate that there is a significant negative relationship between financial statement comparability and cost of equity with a path coefficient = -0.36 at p-value = 0.017 (less than 0.05). Therefore, the first hypothesis is supported.

These results are consistent with prior studies (e.g., Bordeman et al. 2019; Elhoshy 2020; Huang and Yan 2020; Majeed and Yan 2021), as financial statement comparability helps in reducing information asymmetry and providing more information, that helps in making more efficient investment decision, and reducing cost of capital.

9-6-3-2 Results of Testing the Second Hypothesis

The second hypothesis tests whether there is a significant positive relationship between financial statement comparability and financial reporting quality. The statistical results in table (7) indicate that there is a significant positive relationship between financial statement comparability and accruals quality with a path coefficient = 1.02 at p-value = 0.000, that means H2 is supported.

These results are consistent with prior studies (Chen et al. 2016; Chen and Gong 2019; Shuraki et al. 2020; Ejazi et al. 2022), as financial statement comparability helps managers to better understand the firm environment, resulting in better estimation of the current and future performance, and so providing high quality financial reporting.

9-6-3-3 Results of Testing the Third Hypothesis

The third hypothesis tests whether there is a significant negative relationship between financial reporting quality and cost of equity. The statistical results in table (7) indicate that there is a significant negative relationship between accruals quality and cost of equity with a path coefficient = -0.43 at p-value = 0.000. Therefore, hypothesis H3 is supported.

These results are consistent with prior studies (Heflin et al. 2016; Eliwa et al. 2016; Habib et al. 2019; Amrah and Hashim 2020; Muttakin et al. 2020), as financial reporting quality provides more efficient financial information, that reduces information asymmetry, which helps investors in better estimating of the available investment decisions, and better estimating of the expected return, this reduces cost of capital.

9-6-3-4 Results of Testing the Fourth Hypothesis

The fourth hypothesis tests whether financial reporting quality intermediates the relationship between financial reporting quality and cost of equity. Table (8) summarizes the statistical results for the direct effect; indirect effects; and total effects to test the fourth hypothesis:

Table (8): The Statistical Results of H4

Path	Effect	Path Coefficients	P-value
Comparability ---> Cost of Equity	Direct	-0.36	0.017
Comparability---> ACCR---> Cost of Equity	Indirect	-0.44	0.000
Comparability---> ACCR---> Cost of Equity	Total	-0.79	0.000

The statistical results in table (8) indicate that there is an indirect effect which is significant and negative between financial statement comparability and cost of equity through accruals quality as an intermediate variable, with a path coefficient = -0.44 at p-value = 0.000. Therefore, hypothesis H4 is supported. Also, the results indicates that the direct and indirect effects are both significant, which means that the mediation effect is partial, as it explains only part of the relationship between the independent and the

dependent variables, but the other part of this relationship is explained by the direct effect between them.

9-7 Additional test

The aim of conducting the current additional test is to support the results of the main test. Therefore, the researcher will use an alternative measure for the dependent variable (cost of capital), which is cost of debt. Consistent with previous studies (e.g., El Madbouly 2016; Khedr 2020; Amrah and Hashim 2020; Muttakin et al. 2020), the researcher will measure cost of debt through using the following equation:

$$\mathbf{COD_{i,t} = (IE_{i,t} / TD_{i,t}) * (1 - TR)}$$

Where, $COD_{i,t}$ is cost of debt for firm i , for the period t ; $IE_{i,t}$ is interest expense for firm i , for the period t ; $TD_{i,t}$ is total debts for firm i , for the period t ; and TR is tax rate. The researcher will use the path analysis technique in structural equation modeling (using AMOS 26 in SPSS software) in testing the hypotheses in this additional test.

The researcher will estimate the fit indices of the model, and make sure that these indices are within the acceptable ranges. Then, the researcher will test the research hypotheses, by using cost of debt as a measure for cost of capital. This will be illustrated in the next section.

Based on the previous discussed indices of structural equation modeling, the researcher will summarize these indices; its acceptable ranges and whether the proposed model is fit or not according to these indices in table (9).

Table (9): Fit Indices of Structural Equation Modeling

Index	Abbreviation	The acceptable range	The proposed model	Fit or not?
Chi-Square X ²	CMIN/DF	<ul style="list-style-type: none"> • Less than 5 is fit. • Less than 2 is completely fit. 	1.973	Fit
Root Mean Square Error of Approximation	RMSEA	<ul style="list-style-type: none"> • Less than or equal 0.05 is completely fit. • Between 0.05 and 0.1 is fit. • Greater than 0.1 is not fit. 	0.044	Fit
Goodness of Fit Index	GFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.90 is a good fit. 	0.902	Fit
Adjusted Goodness of Fit Index	AGFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.90 is a good fit. 	0.934	Fit
Root Mean Square Residual	RMR	<ul style="list-style-type: none"> • More than 0. • Less than 0.1. 	0.063	Fit
Normed Fit Index	NFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.95 is a good fit. 	0.915	Fit
Comparative Fit Index	CFI	<ul style="list-style-type: none"> • Between 0 and 1. • Greater than 0.95 is a good fit. 	1.000	Fit

***Source:** developed by the researcher.

By analyzing the acceptable ranges of fit indices of structural equation modeling, the researcher found that the proposed model is statistically fit. And table (10) summarizes the statistical results for the direct effect of financial statements comparability on cost of debt (hypothesis 1); the direct effect of financial statement comparability on financial reporting quality (hypothesis 2); and the direct effect of financial reporting quality on cost of debt (hypothesis 3).

Table (10): The Statistical Results of H1, H2, and H3

Hypotheses	Path	Direct Effect	
		Path Coefficients	P-value
H1	Comparability ---> Cost of Debt	-0.055	0.03
H2	Comparability ---> ACCR	1.02	0.000
H3	ACCR ---> Cost of Debt	-0.038	0.028

The statistical results in table (10) indicate that there is a significant negative relationship between financial statement comparability and cost of debt with a path coefficient = -0.055 at p-value = 0.03. Therefore, the first hypothesis is supported as the basic test. However, the path coefficient in the additional test is lower than the path coefficient in the basic test. Therefore, the researcher concludes that the cost of equity is a better measurement for cost of capital than cost of debt.

Concerning the second hypothesis, the statistical results in table (10) indicate the same exact results of the basic test (same path coefficient and same significance), which supports the results of the basic test. Therefore, the second hypothesis is supported.

Concerning the third hypothesis, the statistical results in table (10) indicate that there is a significant negative relationship between accruals quality and cost of debt (path coefficient = -0.038 at p-value = 0.028). Therefore, the third hypothesis is supported.

The fourth hypothesis tests whether financial reporting quality intermediates the relationship between financial reporting quality and cost of debt. Table (11) summarizes the statistical results for the direct effect; indirect effects; and total effects to test the fourth hypothesis as follows:

Table (11): The Statistical Results of H4

Path	Effect	Path Coefficients	P-value
Comparability ---> Cost of Debt	Direct	-0.055	0.03
Comparability---> ACCR---> Cost of Debt	Indirect	-0.038	0.000
Comparability---> ACCR---> Cost of Debt	Total	-0.093	0.000

The statistical results in table (11) indicate that there is an indirect effect which is significant and negative between financial statement comparability and cost of debt through accruals quality as an intermediate variable, with a path coefficient = -0.038 at p-value = 0.000. Therefore, hypothesis H4 is supported. Also, the results indicates that the direct and indirect effects are both significant, which means that the mediation effect is partial, as it explains only part of the relationship between the independent and the dependent variables, but the other part of this relationship is explained by the direct effect between them.

In summary, by comparing the results of the additional test -which uses cost of debt in measuring cost of capital instead of cost of equity- with the results of the basic test, the researcher concludes that the cost of equity is a better measure for cost of capital, as the statistical results indicate higher values of path coefficients in the basic test compared to the additional test.

10-Summary, Conclusion, Recommendations and Future Research

In this section, the researcher presents the research summary, results and conclusions from a theoretical and empirical view, in order to answer its questions. In addition, the researcher highlights some recommendations and fields for future research as follows:

Financial statement comparability is considered a basic concept, that interested many researchers in the latest studies. The current research has highlighted this concept through performing the research objectives, which are examining the relation between financial statement comparability and each of financial reporting quality and cost of capital.

The researcher tried to present a reasonable contribution in this field, through examining these relationships, especially the effect of financial reporting quality on the relation between financial statement comparability and cost of capital, as an intermediate variable. So, the current research is the first research that examines this relationship, and this is the contribution of this research.

The first research question is "***What is financial statement comparability? And how it can be measured?***". The researcher concluded that financial statement comparability can be defined as a qualitative characteristic that enables financial statements users to compare financial statements items. Whereas it shows the extent to which similar transactions are accounted for similarly, and different transactions are accounted for differently, for a given set of economic events.

Concerning the benefits of financial statement comparability, the researcher concluded that there are benefits to financial statements users; managers; and analysts, through judging firm performance; providing better benchmarks for one another; helping in better understanding the similarities and differences among accounting items; being more knowledgeable of the firm's competitors and economic conditions; and lowering the cost of acquiring information.

Concerning measuring financial statement comparability, the researcher concluded that the model of De Franco et al. (2011) is the appropriate model to measure financial statement comparability. According to De Franco et al. (2011), comparability is the degree to which earnings change over time for two firms in the same industry. In other words, if two accounting systems are similar, their output should be comparable.

The second research question is "***Is there a relationship between financial statement comparability and cost of capital?***". Concerning the cost of capital definition, the researcher concluded that cost of capital is the expected return on the firm's equity and is the weighted average cost to all sources of capital.

Concerning factors affecting cost of capital, the researcher concluded that there are many factors that can affect cost of capital such as accounting information; the level of disclosure; information asymmetry; the level of liquidity; and conservatism. Concerning the components of cost of capital, the researcher concluded that there are two main components for cost of capital which are cost of equity and cost of debt.

Therefore, the researcher used cost of equity measure in the basic test, while using the cost of debt measure in the additional test.

Theoretically, findings of prior studies indicated that financial statement comparability helps in reducing information asymmetry, and making more efficient investment decisions, so investors demand relatively lower expected returns, resulting in lower cost of capital. Therefore, there is a negative relationship between financial statement comparability and cost of capital. Practically, the statistical results of the current research supported this relationship, through supporting the first research hypothesis.

The third research question is *"Is there a relationship between financial statement comparability and financial reporting quality?"*. Concerning the definition of financial reporting quality, the researcher concluded that financial reporting quality is the precision of financial reporting, that provides complete and relevant information, which is faithfully represents the firm's financial position, in order to help financial statements users in making the appropriate decisions.

Concerning measuring financial reporting quality, the researcher concluded that there are four strategies to measure financial reporting quality which are using accounting-based measures; market-based measures; benchmarking; and operationalization of qualitative characteristics.

Theoretically, findings of prior studies indicated that financial statement comparability reduces the cost of acquiring and processing information, so making it easier to reach information. Also, financial statement comparability enables managers to produce more reliable estimates and better signals of future firm performance. In other words, managers with greater understanding of the firm environment will be able to have high quality reporting. Therefore, there is a positive relationship between financial statement comparability and financial reporting quality. Practically, this relation was supported by the statistical results of the current research, through supporting the second research hypothesis.

The fourth research question is *"Is there a relationship between financial reporting quality and cost of capital?"*. Theoretically, findings of prior studies indicated that from one hand, investors demand for higher expected return, due to

information asymmetry resulting from poor quality of financial reporting, which leads to higher cost of capital. And from another hand; investors require reliable and relevant information to assess the financial position of the firm, and financial reporting provides investors with such information. Therefore, there is a negative relationship between financial reporting quality and cost of capital. Practically, this relationship was supported, through supporting the research third hypothesis by the statistical results of the current research.

The fifth research question is *"Is financial reporting quality affects the relation between financial statement comparability and cost of capital as an intermediate variable?"*. According to the statistical results of the current research, the researcher concluded that financial reporting quality intermediates the relation between financial statement comparability and cost of capital, through supporting the research fourth hypothesis. As financial statement comparability is considered one of the enhancing characteristics, which improves financial reporting quality, which in turn reduces cost of capital.

Concerning the basic test, it depended on the path analysis technique –one of the structure equation modeling techniques- to test the research hypotheses, using the AMOS program, version 26, in SPSS software. The sample of this test was 70 non-financial Egyptian firms listed in the Egyptian stock market, from 10 sectors, for the period 2017-2020, resulting in 280 observations. The statistical results of the basic test supported the research hypotheses. Indicating that there is a significant negative relationship between financial statement comparability and cost of capital; a significant positive relationship between financial statement comparability and financial reporting quality; a significant negative relationship between financial reporting quality and cost of capital; and lastly financial reporting quality intermediates the relation between financial statement comparability and cost of capital.

Concerning the additional test, it used a different measure for cost of capital, which is cost of debt instead of cost of equity. The statistical results of the additional test supported the research hypotheses, considering cost of equity as a better measure for cost of capital compared to cost of debt. As the measure of cost of equity depends on information related to the market such as the share price; the earnings per share; and the

dividend per share, while the measure of cost of debt depends on only information about the firm's debts.

Concerning recommendations, and according to the research theoretical and empirical results, the following recommendations can be summarized.

First, performing more research on the relation between financial statement comparability and cost of capital, through using different measures for both of them, as it is an area of interest for many researchers.

Second, performing more research on the mediation effect of financial reporting quality on the relation between financial statement comparability and cost of capital, through using different measures for financial reporting quality, in order to have more representative results.

Third, performing more research concerning the Egyptian environment, as most previous studies are implemented in developed countries rather than developing ones.

Fourth, taking into consideration the results of this research and other future researches while assessing the company law, because it will be important for firms to know the importance of financial statement comparability in enhancing financial reporting quality, and in reducing cost of capital.

Fifth, taking into consideration the importance of financial statement comparability and its benefits, while assessing the Egyptian accounting standards.

Last but not least, encouraging the Egyptian stock market to make a more efficient data set, which helps in reducing information asymmetry, and in turn helps in assessing financial statement comparability more easily.

Concerning future research, the following points can be fruitful for future research, according to the research results, limitations, and contribution,:

- Examining the effect of firm characteristics on financial statement comparability.
- Examining the effect of firm life cycle on the relation between financial statement comparability and cost of capital.

- Examining the effect of adopting the International Financial Reporting Standards on financial statement comparability.
- Examining the effect of financial statement comparability on auditor's fees.
- Examining the effect of financial statement comparability on financial analysts' forecasts.
- Examining the effect of corporate governance mechanisms on cost of capital.
- Examining the mediation effect of voluntary accounting disclosure on the relation between financial statement comparability and cost of capital.
- Examining the effect of ownership structure on financial statement comparability.
- Examining the mediation effect of financial reporting quality on the relation between financial statement comparability and investment efficiency.
- Examining the mediation effect of cost of capital on the relation between financial statement comparability and investment efficiency.

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